FILE COPY

IN THE

Supreme Court of the United States.

OCTOBER TERM, 1931.

No. [redacted] 8

NATIONAL SURETY COMPANY, et al.,
Petitioners (Appellants Below),

vs.

VALERIA E. CORIELL,
Respondent (Appellee Below),

MORRIS WHITE, INC.,
Respondent (Appellee Below),

IRVING TRUST COMPANY,
as Receiver of Morris White, Inc.,
Respondent (Appellee Below),

MICHAEL HOLLANDER, et al.,
constituting a Committee of Creditors of Morris White, Inc.,
Respondent (Appellee Below).

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT, AND BRIEF IN SUPPORT THEREOF.

CHARLES H. TUTTLE,
SELDEN BACON,
SAUL S. MYERS,
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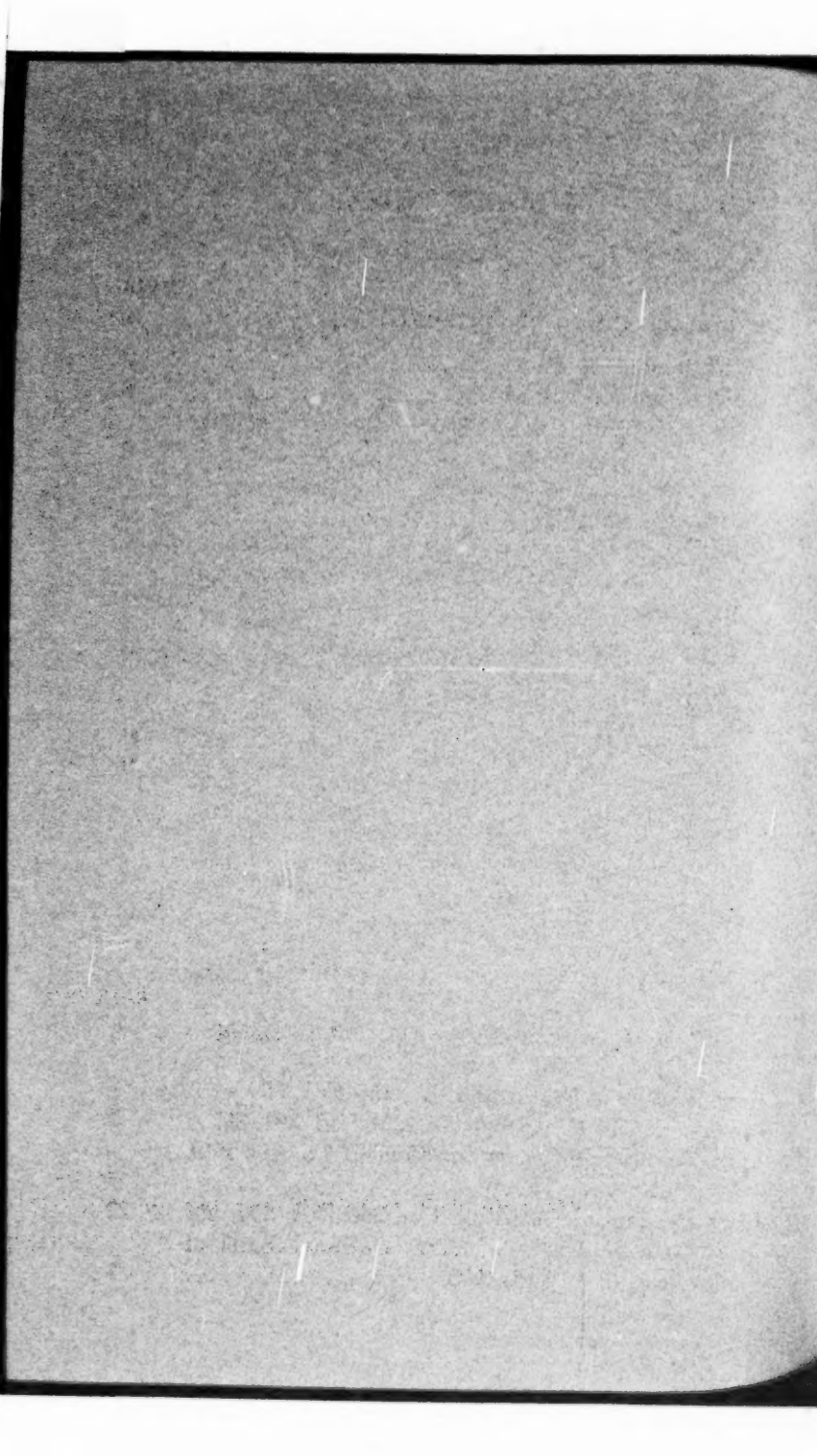

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT, AND BRIEF IN SUPPORT THEREOF.

TO THE HONORABLE CHARLES E. HUGHES, THE CHIEF JUSTICE OF THE UNITED STATES AND THE ASSOCIATE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES:

National Surety Company, American Credit Indemnity Company, London Guaranty & Accident Company, Ltd., Hermann Loewenstein and G. Levor & Co., Inc., the

above-named petitioners, respectfully pray that a writ of certiorari issue to review the decree of the United States Circuit Court of Appeals for the Second Circuit entered on November 25, 1931, purporting to reverse (but actually only modifying) the decree of the United States District Court for the Southern District of New York, dated June 15, 1931, and made by Judge Knox, authorizing the Irving Trust Company, as receiver of the property of the defendant Morris White, Inc., to accept an offer of Lily White for all the property of that corporation.

Simultaneously herewith, petitioners are presenting to this Court a petition for writ of certiorari to review the decree of the United States Circuit Court of Appeals for the Second Circuit, also entered on November 25, 1931, affirming the decree of the United States District Court for the Southern District of New York, dated June 3, 1931, and made by Judge Knox, making the Irving Trust Company permanent receiver of the defendant Morris White, Inc.

Statement.

On April 6, 1931, Valeria E. Coriell, one of the respondents, as assignee of New Jersey National Bank & Trust Company, the holder of the demand note of Morris White, Inc. for $27,900, filed a bill of complaint in equity against Morris White, Inc., one of the respondents, alleging that although Morris White, Inc. was then solvent, its accrued liabilities were in excess of its quick assets and requested the appointment of a receiver because Morris White, Inc. was then and for some time in the future would be unable to meet its matured and maturing obligations. Morris White, Inc., whose business was the manufacturing and selling of ladies' handbags and other fancy leather goods, filed its answer admitting the allegations of the bill of complaint and consented to the appointment of a receiver (fol. 32).

Valeria E. Coriell is a simple contract creditor. She has obtained no judgment. She does not profess to hold any collateral security. Morris White, Inc. is simply Morris White (fol. 542).

By decree of June 3, 1931, the receivership was made permanent (fol. 631) and thereafter by decree dated June 15, 1931, the court approved an offer submitted by Lily White, wife of Morris White, the president of Morris White, Inc., for the "purchase" of the assets of Morris White, Inc. The offer contemplated the formation of a new corporation to be known as Morris White Handbags Corporation, with a capital of 10,000 shares consisting of 1,000 of no par common and 9,000 preferred of the par value of $100 per share. The common stock had the voting power. It was to be issued at the pleasure of the directors and was to go to Morris White who had the appointment of a majority of the board of directors. The preferred stock was to be used in extinguishment of 80% of the creditors' claims (fols. 101-107). The remaining 20% of the claims was to be "paid" in non-interest bearing, unendorsed and unsecured promissory notes of the new corporation (fols. 128, 129).

No new capital, in money or assets, was provided (fol. 244). No cash was paid (fol. 244). No security was given or tendered. No public sale,—not even an actual private sale—took place. Actually, all that happened was (to quote the words of Judge Knox) "a taking" by the insolvent White of "all the assets of the creditors and wiping them out, with the exception of 20% of their claims and subjecting them to the hazards of the (new) enterprise",—a result whereby he "got the capital of the creditors there for years at his disposal" (fols. 432-3, 404).

At the time when the offer was made, Morris White, Inc. was insolvent within the meaning of the Bank-

ruptcy Act. The cash on hand on April 6, 1931, when the bill of complaint was filed and the temporary receiver was appointed, was only $5,600, whereas the total liabilities were $1,072,000 (Rec., pp. 198, 199).

The receiver's counsel estimated "the total asset position" of the transferee company (Morris White Handbags Corporation) as only $583,500 without taking into consideration the estimated administration expenses of $50,000 or the unfixed fee of the counsel of the so-called Creditors' Committee or the priority liens of the Federal and State Governments for $158,000, and "without taking any cognizance of the miscellaneous frozen assets, intercorporate claims" which obviously were of merely problematic worth (fol. 453).

A preferential payment of over $25,000 had to be made to a judgment-creditor (fols. 175-8, 186-229).

The defendant corporation had "not a dollar" of orders on hand and the market was constantly falling (fols. 248, 457-8).

Nearly $2,000,000 of the company's assets had been diverted by White to a personal venture which had become bankrupt (fols. 540-2, 411, 359). White himself was bankrupt (fols. 393-4).

In other words, the actual picture was one of insolvency, presenting a typical case for the Bankruptcy Act and for the rigid investigation under Section 21-A.

In keeping with this picture, no rehabilitation of the debtor corporation was possible or was attempted. The opposite course was taken. Eighty per cent of its indebtedness to its creditors was wiped out by mere fiat of the court; the remaining twenty per cent was transferred to and assumed by another corporation which had no assets of its own and which received no new capital from any source. Morris White, Inc., instead of being revived, was killed.

The petitioners, whose claims aggregate over $120,000 (fols. 279, 280, 600-608), opposed the approval of the

offer and claimed that by reason of the defendant's bankruptcy, the court should relinquish jurisdiction of the defendant in equity and allow the defendant and its creditors to pursue their rights and remedies in bankruptcy (fols. 258, 263-5, 273-4, 294-5, 606-7).

The Circuit Court of Appeals unanimously "reversed" the order of the District Court with an opinion per Manton, C. J., 54 F. (2d) 255. The fundamental propositions of this opinion were:

> 1. There was no power in the District Court to compel any contract creditor to accept, in extinguishment of his claim, the preferred stock and unsecured obligations of a new industrial corporation, without the payment of any cash.
>
> 2. The petitioners were entitled to receive their proportionate share of the proceeds of a conventional sale of the property in cash.
>
> 3. The rights of petitioners can be satisfied by giving them in cash, in lieu of a sale, an aliquot share of what would have been realized if the property of Morris White, Inc. had been sold at public auction, or, at their option, by giving them in cash an aliquot share of the value of the preferred stock and notes offered to them by the so-called reorganization plan and as of its date.

The opinion of the Circuit Court of Appeals concludes:

> "Thus the appellants will be placed in a position of having awarded to them what would be the result if a distribution of the proceeds of a sale of the assets of the corporation had been made. If payment is not thus made in cash, the several amounts which appellants are found entitled to may be collected by a sale of the property transferred to the new corporation. This enables the minority creditors, in a practical manner, to obtain cash in payment, or part payment of their indebtedness."

The Questions Presented.

1. Did the Circuit Court of Appeals rightly decide that the petitioners' right was merely to an aliquot share in cash of such sum as a Special Master may find would have been realized if the property of Morris White, Inc. had been sold at public sale on June 15, 1931?

2. Or should the Circuit Court of Appeals have reversed entirely the decree of the District Court dated June 15, 1931, and have directed that the property of the defendant be sold?

3. Did the Circuit Court of Appeals rightly decide that the rights of these petitioners could be fully protected by relegating them, months after the actual transfer had occurred, to a mere guess of a Special Master as to what might have been realized at a public sale six or more months previously, which sale was never held and the terms and methods of which were never determined?

4. If the Circuit Court of Appeals was otherwise right, did it rightly limit the security of the petitioners for the payment of their aliquot share in cash to what might be collected by a sale of the property of Morris White, Inc. transferred to the new corporation, notwithstanding that in the interval much of that property would inevitably be consumed in the new corporation's business before such a sale could be made?

Reasons Relied On for the Allowance of the Writ.

A.

The Circuit Court of Appeals erred in holding that these petitioners merely had a right to an aliquot share in cash of whatever sum the Special Master might find as the realizable value of the property of Morris White,

Inc. at public sale as of June 15, 1931, or, at their option, an aliquot share in cash of whatever sum the Special Master might find to be the value of the preferred stock and notes offered to them under the so-called reorganization plan.

In re Prudential Outfitting Co., 250 Fed. 504, 506;
In re J. B. & J. M. Cornell Co., 186 Fed. 859;
In re J. B. & J. M. Cornell Co., 201 Fed. 381, 387;
In re Northampton Portland Cement Co., 185 Fed. 542, 543;
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Gay v. *Hudson River Electric Power Co.*, 184 Fed. 689, 693-4;
Odell v. *Batterman Co.*, 223 Fed. 292, 297, 299;
Pomeroy's Equity Jurisprudence (4th ed.), Vol. 1, Sec. 47, p. 51.

B.

The Circuit Court of Appeals erred in holding that petitioners would have adequate security for payment by decreeing that the sum awarded them might be collected "by a sale of the property transferred to the new corporation", notwithstanding that in the interval much of that property would inevitably be consumed in the new corporation's business before such a sale could be made.

Importance and Novelty of the Questions.

The decision of the Circuit Court of Appeals is without precedent. Nevertheless it will have wide applica-

tion, particularly in these times of economic stress where so many corporations are passing into the hands of receivers.

The rule that the rights of dissenting creditors may be determined by a mere guess by a Special Master at what might have resulted if different action had been taken six months ago under circumstances and possibilities now unknown and unknowable, is an entirely novel proposition.

Neither *Geddes* v. *Anaconda Mining Co.*, 254 U. S. 590; nor *Jones* v. *Missouri Edison El. Co.*, 203 Fed. 945; nor *Kansas City Ry.* v. *Central Co.*, 271 U. S. 445, is authority in any way for the decision of the Circuit Court of Appeals.

As to cases involving reorganizations of public utilities companies, it cannot be too strongly stressed that the rule there applicable is not applicable to private industrial corporations exercising no public franchises and performing no public service the continuance of which is a public necessity. But even in cases of public service corporations the courts have never heretofore relegated non-assenting creditors to uncertainties and to questions unsusceptible of proof. Even in *Northern Pacific Ry.* v. *Boyd*, 228 U. S. 482, Boyd was given direct and positive relief.

The present case, taken together with the accompanying petition for a review of the decree of June 3, 1931, places before this Court for the first time the whole subject of the rights and remedies of non-assenting creditors in connection with a reorganization plan of a purely private industrial corporation.

We respectfully submit that it is of public importance that in the instance of such corporations—and the instances are bound to increase—the limitations of the legal and discretionary powers of a court of equity in this class of subject-matter, should be authoritatively and finally defined.

WHEREFORE, it is respectfully submitted that this petition for a writ of certiorari to review the decree of the Circuit Court of Appeals for the Second Circuit should be granted.

NATIONAL SURETY COMPANY
AMERICAN CREDIT INDEMNITY COMPANY
LONDON GUARANTY & ACCIDENT COMPANY, LTD.
HERMANN LOEWENSTEIN
G. LEVOR & CO., INC.

CHARLES H. TUTTLE,
SELDEN BACON,
SAUL S. MYERS,
of Counsel.

BRIEF IN SUPPORT OF PETITION.

Opinion Below.

The opinion of the Circuit Court of Appeals for the Second Circuit is reported in 54 F. (2d) 255. Judge Knox rendered no formal opinion.

Jurisdiction.

The decree of the Circuit Court of Appeals was entered in the office of the Clerk of the United States Circuit Court of Appeals for the Second Circuit on November 25, 1931.

Jurisdiction to issue the writ is found in the provisions of Section 240-A of the Judicial Code as amended by the Act of February 13, 1925.

Statement of Facts.

The principal facts are stated in the foregoing petition.

The following supplemental statement is now made.

Morris White himself asserts that "Morris White, Inc. is Morris White" (fol. 542). He is a director and stockholder in the Bank of United States, with all the possibilities destructive of financial credit which that double relationship implies (fol. 532).

He admitted that he personally owed Morris White, Inc. $137,729.68, representing money taken by him from it and employed in his other ventures, particularly in the Morris White Holding Company which he used in his real estate speculations and of which he is the sole stockholder (fols. 538-9, 542). That company also is in bank-

ruptcy (fol. 359). It is also indebted to Morris White, Inc., for $1,700,000 representing additional moneys diverted by White from Morris White, Inc. to the Morris White Holding Company. There is no security for either of these debts (fol. 539).

In other words the insolvency of Morris White, Inc. is due solely to the fact that Morris White for his personal ends took from it and lost nearly $2,000,000 constituting part of the trust fund for its creditors. Yet, below, that conduct was not only not condemned but was actually rewarded by what is nearly tantamount to a gift of the remainder of the trust fund (fols. 582, 307) **and a proposed salary from the new corporation of $60,000 a year** (fols. 509, 510).

The "reorganization plan", approved by the District Court and continued by the Circuit Court of Appeals except as against these petitioners, had in it for White and certain favored creditors a number of advantages which, in the vernacular, are commonly called "jokers". Some of them are as follows:

1. The (secured) creditors are enabled, notwithstanding their security, to receive notes for 20% of their entire claims.

2. Notwithstanding the opening euphemisms of the White offer (fols. 103-5), the end of the offer discloses that *the creditors do not really get any preferred stock at all* but only voting trust certificates in a voting trust to last for ten years and to be composed of two creditors in whose selection the creditors generally have no voice whatever (fols. 140-3).

3. Of the five directors Morris White is to designate three, and the voting trustees two (fol. 110).

4. While the promissory notes are still outstanding, White may fix the salaries of himself and his associates at any figure he may please, provided he can secure the support of one of the directors in addition to the three controlled by himself (fols. 111-2).

5. He stated that he expected for himself a salary of $60,000 a year (fols. 509, 510).

6. The new company is under no obligation to pay dividends on the preferred stock until January 1, 1934 (fol. 114).

7. White keeps indefinite control of the capital of the creditors, and if the profits never exceed the executive salaries he is endowed for life.

8. Even the provision for the redemption of the preferred stock works in White's favor, because he is obliged to apply in redemption only "one-third of the said earned net operating profits of the said corporation for said fiscal year" (fols. 116-7). In other words out of every $3 which the new corporation earns with the creditors' capital, he can keep $2 in reserve for his common stock and return only $1 to his creditors.

9. To White, who controls a majority of the board of directors is expressly reserved the power, without consulting the preferred stock, to mortgage or sell the property of the new corporation or bring about its voluntary dissolution (fols. 104-6).

10. In conjunction with the voting trustees he can even cause the new corporation to guarantee the bonds or obligations of any other corporation (fols. 104-6).

11. To the two voting trustees is reserved the right to increase the preferred stock or create any other class of preferred stock (fol. 107).

12. The provisions for fees contains no limitations, and the fee to the attorney of the so-called Creditors' Committee is left entirely to himself and to the new corporation, to wit, to himself and White (fols. 125, 128).

13. White is not required to give any security for performance on his part, and is under no obligation to return any portion of the creditors' capital over and above the 20%.

14. White is under no pledge to procure new money. He runs the new corporation at the risk of the creditors of the old corporation and on the money obtained from them for forced levy.

15. Behind the carefully constructed screen of the White offer, the fact is discernible that the creditors, either individually or as a class, have no voice at all in the control of the new corporation.

16. The White offer, at every point, gives no advantage to the sole stockholder of the old corporation (to wit, White) over its creditors,—directly contrary to the "first principle" announced in the *Boyd* case, 228 U. S. 482.

The judicial acceptance of this offer did not constitute a public sale,—or even a private sale in any true sense of the term.

Neither White nor the new corporation (Morris White Handbags Corporation) paid anything at all either to the corporation or to the creditors. No security even was given. No new money or new assets were provided (fol. 244). On the contrary, *it was the creditors who*

paid. They paid by the surrender (compelled by the Court) of 80% of all their claims.

On the second day of the hearings (May 27th), the Receiver's counsel presented a condensed statement of assets and liabilities, prepared by accountants as a summary of the books as of April 6th, the day this action was commenced (fols. 288, 289; Rec., p. 198). But no one claimed that this statement of book amounts had any relation whatever to reality,—indeed, everyone conceded that it did not (fols. 452-4).

Specifications of Error.

1. The Circuit Court of Appeals erred in not directing that Morris White, Inc. be liquidated on the bankruptcy side of the court.

2. The Circuit Court of Appeals erred in not entirely reversing the decree of the District Court dated June 15, 1931, instead of deciding that the petitioners' right was merely to an aliquot share in cash of such sum as a Special Master may find would have been realized *if the property of Morris White, Inc. had been sold at public auction* on June 15, 1931.

ARGUMENT.

I.

The power exercised by the Circuit Court of Appeals is without precedent. It is the first decision of its kind.

Until this instance, it had always been assumed, in the case of private commercial corporations, that no so-called reorganization by which the corporation is stripped

of all its assets could be effected without the consent of all creditors unless a conventional sale or its equivalent occurred. The usual practice has been for the reorganization committee to get into its possession as many claims as possible and then to bid upon the public sale, applying against the purchase price the amounts realized on the claims so held.

But by the decision of the Circuit Court of Appeals this time honored procedure is scrapped. Under that decision, a group of the creditors may, through a court of equity, do what they could not possibly do under the Bankruptcy Act nor under the equity practice as it has heretofore been understood, to wit: dispense altogether with any sale, public or private, cause the assets to be transferred to a new corporation organized by themselves without new capital, money or assets; and, without making any payment, throw upon the other creditors the duty and expense of employing lawyers and accountants in undertaking to make impossible proof, namely, the amount which the assets would have realized if sold at a theoretical public sale held six months previously under terms of sale which had never been fixed, with a manner of advertising now undeterminable, and with circumstances of bidding now unknowable.

The burden and expense thus thrust upon minority creditors is practically prohibitive. Even if they undertake it, the proposition which they are required to establish can, at best, be a mere guess and undeterminable by any practical standards,—a proposition moreover, as to which they will almost certainly be overwhelmed by a flood of interested or inspired testimony (entirely safe and easy) from the officers and favored creditors to the effect that a public sale would have yielded little or nothing.

In consequence, for all practical purposes, the decision of the Circuit Court of Appeals comes to the same thing

as the decision of the District Court, which decision compelled the dissenting creditors to take stock and notes without any cash.

Why should those who desire to go on with the business be entitled to place this burdensome penalty and this incalculable risk upon those who do not desire to have their capital compulsorily confiscated (without payment) for a new corporation and a new hazard over which they have no control? Why should they be permitted to deprive non-assenting creditors of that actual demonstration and proof which the conventional sale affords?

If a group of creditors desires to transfer all the assets of a purely private enterprise to a new corporation, why should they not be required to buy in the usual manner and at public sale and thus provide the capital for and take the risk of their own speculation, without the right of extorting a compulsory contribution from others or putting others to the burden, expense and delay of an impossible solution of an abstract conundrum? If such a result cannot be accomplished out of court, by what magic, in case of a purely private enterprise, can it be accomplished in court?

Dispensing with a public sale was in no sense a necessity for the assenting creditors in the present case and cannot be a necessity in any case. They were entirely free to organize their own corporation and to bid at the sale. If the property sells for little or nothing, they are advantaged. If it sells for a great deal, the non-assenting creditors are the more protected in their enjoyment of their contract rights. In either event, the law has proceeded with certainty, in accordance with the best evidence, and with fairness to all.

Dispensing with a public sale, as was done in this case, enables the assenting creditors to nullify the constitutional rights of the non-assenting creditors, to avoid the actual test which a conventional sale provides, to

deny to the non-assenting creditors the protection of public advertisement with proper inventories and appraisals, and to throw upon them an expense and a hazard which, while doing lip-service to the letter of their rights, destroys their substance and denies their spirit.

Such a result and such a precedent are, we submit, contrary to public policy. It puts the enjoyment and protection of rights not on the solid basis of reality but upon the quicksands of guesswork and speculation. It impairs, by indirection, the obligation of contracts. It enables a group of interested creditors to confiscate the capital and property rights of those who disagree with them and to substitute in exchange a paper interest in a pure hazard.

The difference between the decision of the Court of Appeals and the decision of the District Court is theoretically large but practically none at all. The difficulties to which the former subjects the non-assenting creditors is substantially equivalent to the exclusion which the latter imposed.

II.

But there are further considerations of law and policy.

How can any Special Master ascertain "the value of the assets as if sold at public sale" under conditions which have long since passed and which cannot be reconstructed?

In the present case, there was at no time either an inventory, or a verified and adequate accountants' statement, or an appraisal. The failure of the District Court to require such protective proofs before proceeding to authorize the transfer, was one of the non-assenting creditors' chief complaints (fols. 275, 293-7, 299, 476-7, 500-1, 514-7, 520-3, 543-7). Nor did the Circuit Court of Appeals have before it either inventory, verified accountants' statement or appraisal.

Why should the creditors, who properly opposed their compulsory inclusion in the paper reorganization, be now left without practical relief because of the erroneous ruling, now reversed, by which they were prejudiced?

In the interval of time since June 15, 1931, the new corporation undoubtedly consumed or sold much of the merchandise transferred to it by the decree of that date. How can an inventory of the property then transferred now be prepared? How can it now be told precisely what property was available for sale on that date? How can these petitioners, who had no connection with the business at that time, now meet the self-interested testimony which would be offered by White and the assenting group as to the identity, nature and value of the property then on hand?

Moreover, is the Special Master to determine the value of each asset at cost less depreciation? Is he to take as the standard the market value? Is he to consider what would be paid by a going business or by a junk dealer? How is he to determine how many bidders would come forward in response to advertisement, the extent and manner of which cannot now be known? How is he to know how much the sale would have been enhanced by a proper inventory, appraisal and adequate accountants' statement which actually never existed? How could he know what would have influenced the bidders, or how good, bad or indifferent their competition would have been?

Furthermore, the decision of the Circuit Court of Appeals has the effect of attempting to measure payment to these petitioners by the most disadvantageous method of a theoretical *ex post facto* sale. At the time the District Court made its order the property might have been offered at public or private sale, in separate items or as a going concern; and comparison might have been made of the results with the White offer. But under the decision of the Circuit Court of Appeals the measure is the theo-

retical price which may now be deemed to have been procurable at the auction block without ever being able to know the results of the incentives, or the comparison of terms, which could have been ascertained by the District Court.

What the fair value of the property was on June 15, 1931 would (if there had been a proper inventory) be susceptible of proof; but what it would then have realized at a public sale is not now susceptible of proof. The consequences should fall, not upon those who stood upon their just rights, but upon those who illegally created the situation.

In re Prudential Outfitting Co., 250 Fed. 504, 506, and cases cited in the petition for certiorari.

III.

For the foregoing reasons an authoritative settlement by this Court of the questions and principles involved is urgent.

The direction of the Circuit Court of Appeals is entirely new in character. It substitutes guesswork for proof. It opens the door for all sorts of new abuses of a method of procedure already too much abused. It permits by indirection the very thing which, when directly done, it condemns. It impairs the obligation of contracts, confiscates vested rights, and usurps a power not resident in any court, whether of equity or otherwise.

Respectfully submitted,

CHARLES H. TUTTLE,
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